

Modification proposal:	<b>Balancing and Settlement Code (BSC) P333: Inclusion of DSBR volumes into the cash-out price in time for publication after the end of the Settlement Period (P333)</b>		
Decision:	The Authority <sup>1</sup> directs that this modification be made <sup>2</sup>		
Target audience:	National Grid Transmission Plc (NGET), Parties to the BSC, the BSC Panel and other interested parties		
Date of publication:	2 August 2016	Implementation date:	3 November 2016

## Background

Electricity market participants are exposed to imbalance prices (known as the cash-out price) when they generate or consume more or less electricity than they have contracted for. The difference between actual electricity generated or consumed in a half hour period and the volume parties have contracted for is known as their imbalance volume. Cash-out prices are a key incentive to balance because parties face these prices on their imbalance volumes.

To provide the proper incentive, cash-out prices need to be accurate in the short term in order to form appropriate and timely market signals. It is important that the cash-out price reflects the true cost of actions taken by National Grid Electricity Transmission (NGET) in managing imbalances. The imbalance calculation used to derive the cash-out price is composed of a number of factors. One of those factors is Demand Side Balancing Reserve (DSBR)<sup>3</sup> volumes.

The indicative cash-out price is calculated within 20 minutes (and then published within 45 minutes) of the end of every settlement period to provide a 'best-estimate' to market participants. However, an improved imbalance price, that contains more accurate volumes and data, is published five working days later, as part of the interim information (II) settlement run. This calculation reflects the actual volumes used by NGET in deriving the II settlement run imbalance price. Currently, DSBR volumes are not included in the indicative cash-out price but are incorporated into the II settlement run cash-out price after five working days.

## The modification proposal

The modification proposer, Engie, raised this proposal on 28 January 2016. They contend that not including DSBR volumes in cash-out until the II settlement run could result in misleading real-time signals being provided to market participants. This could lead to sub-optimal trading decisions being made on days when there is scarcity in the market.

DSBR volumes can have a potentially significant impact on the cash-out price because it is priced at the Value of Lost Load (VOLL) (£3000/MWh).<sup>4</sup> This can lead to very large

<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>3</sup> For more information on DSBR, see our 2013 letter approving the introduction of DSBR as a balancing service: <https://www.ofgem.gov.uk/ofgem-publications/85278/decisiontoacceptngetapplicationtointroducetwonewbalancingservicesandsubsequentconsultationonfundingarrangements.pdf>

<sup>4</sup> Our P305 determination sets out our decision for pricing VOLL at £3000/MWh: <https://www.ofgem.gov.uk/ofgem-publications/94428/p305d-pdf>

positive changes in the cash-out price in the II settlement run calculation compared to that of the initial settlement run.

To resolve the defect, P333 proposes to amend the BSC to require that, in any settlement period where a DSBR action is taken, NGET includes data relating to those DSBR actions within ten minutes after the end of the relevant settlement period so that the data can be used in calculating the indicative cash-out price.

The proposer believes that P333 will better facilitate BSC objectives (b),<sup>5</sup> (c)<sup>6</sup> and (d)<sup>7</sup> by ensuring that correct market signals are being sent thus reducing uncertainty, and ensuring that the whole market would have access to the same information. Further, that reducing the incidence of cash-out price change will improve efficiency in implementing the BSC arrangements.

### **BSC Panel<sup>8</sup> recommendation**

At the BSC Panel meeting on 14 July 2016, a majority of the BSC Panel considered that P333 would better facilitate the BSC objectives and the Panel therefore recommended its approval. The Panel considered that BSC Objectives (b) and (c) are better facilitated by the modification, that there was some detriment against objective (d), and that the impact on objectives (a), (e), and (f) is neutral.

### **Our decision**

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 15 July 2016. We have considered and taken into account the responses to the industry consultations which are attached to the FMR.<sup>9</sup> We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the applicable objectives of the BSC;<sup>10</sup> and
- directing that the modification be made is consistent with our principal objective and statutory duties.<sup>11</sup>

### **Reasons for our decision**

We consider this modification proposal will better facilitate BSC objectives (b) and (c) and have a neutral impact on the other applicable objectives.

P333 will cost around £164,000 to implement and these costs will be largely<sup>12</sup> incurred by NGET. The benefits of this modification are difficult to quantify, but the majority of

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<sup>5</sup> The efficient, economic and co-ordinated operation of the National Electricity Transmission System

<sup>6</sup> Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity

<sup>7</sup> Promoting efficiency in the implementation and administration of the balancing and settlement arrangements

<sup>8</sup> The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC and Standard Special Licence Condition C3 of the Electricity Transmission Licence available at:

[www.epr.ofgem.gov.uk](http://www.epr.ofgem.gov.uk)

<sup>9</sup> BSC modification proposals, modification reports and representations can be viewed on the Elexon website at [www.elexon.co.uk](http://www.elexon.co.uk)

<sup>10</sup> As set out in Standard Condition C3(3) of NGET's Transmission Licence: <https://epr.ofgem.gov.uk>

<sup>11</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989.

<sup>12</sup> Estimated implementation costs of £240 for Elexon and £164,000 for NGET.

working group members considered that the associated benefits outweigh the costs. We agree with working group members that the potential materiality of inaccurate indicative pricing justifies the costs of implementing the modification.

***(b) the efficient, economic and co-ordinated operation of the national electricity transmission system***

Cash-out prices are intended to provide short-term market signals. Currently, if DSBR is called, the indicative cash-out price can differ greatly from the II settlement run cash-out price once DSBR volumes are accounted for. We therefore agree that the current arrangements can result in uncertainty and affect the formation of efficient price signals in the short-term power market.

We agree with the majority of respondents that the proposed solution corrects this issue because more accurate indicative cash-out prices will send clearer signals to the market of the cost of being out of balance. It will also allow for better informed trading decisions, thus enabling more efficient operation of the Transmission System at times when DSBR is called.

In its response to the industry consultation, NGET set out its view that a great deal of the value of P333 has been removed as a consequence of the corresponding changes in relation to Supplementary Balancing Reserve (SBR) no longer being made for this winter.<sup>13</sup> We note that, in some circumstances, where for example DSBR and SBR are dispatched, the modification would not be as effective in furthering this objective than if just DSBR is dispatched. This is due to the fact that SBR is not reflected in the indicative cash-out price, which would still need to be repriced to reflect SBR in the II settlement run. However, even in this situation the information provided in the indicative price will be marginally more accurate than under the status quo.

***(c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity***

Including DSBR volumes in the indicative cash-out price will ensure that all market participants have access to the same information with respect to DSBR at times when DSBR is called. It is important that all parties have access to as much information as possible, and that the provision of that information is transparent. Ensuring that DSBR actions are accounted for in the indicative cash-out price should also assist smaller market participants who might not be able to accurately forecast DSBR volumes. Ensuring market participants have access to the same information relating to DSBR, and the market more widely, provides for a more level playing field.

By reducing uncertainty around later changes to cash-out prices, and providing better information to all market participants, we consider that P333 will facilitate more efficient economic decisions and therefore better facilitate effective competition in the market at times when DSBR is called. We note however that the extent to which uncertainty is reduced is limited in circumstances where SBR is also dispatched, due to SBR not being included in the indicative cash-out price.

***(d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements***

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<sup>13</sup> See section 9 of the P333 FMR, and for more information on BSC Change Proposal (CP) 1460 please see here: <https://www.elexon.co.uk/change-proposal/cp1460/>

We note that the proposer and workgroup considered that including DSBV volumes in the indicative cash-out price would reduce the frequency of DSBV related cash-out repricing, therefore improving efficiency. However, we also understand that a manual solution introduces administrative complexities which led the Panel to conclude that P333 does not represent a more efficient process than the one currently in place. On balance we consider the impact on objective (d) to be neutral.

### **Decision notice**

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority hereby directs that modification proposal BSC P333: *Inclusion of DSBV volumes into the cash-out price in time for publication after the end of the Settlement Period* be made.

**Philippa Pickford**

**Associate Partner – Energy Systems**

Signed on behalf of the Authority and authorised for that purpose